Mutual Funds: Maybe all You'll Ever Need

By the Editors of *Kiplinger's Personal Finance* magazine

Mutual Funds

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Table of Contents

About the Investor Protection Trust

The Investor Protection Trust (IPT) is a nonprofit organization devoted to investor education. Over half of all Americans are now invested in the securities markets, making investor education and protection vitally important. Since 1993 the Investor Protection Trust has worked with the States and at the national level to provide the independent, objective investor education needed by all Americans to make informed investment decisions. The Investor Protection Trust strives to keep all Americans on the right money track. For additional information on the IPT, visit www.investorprotection.org.

Kiplinger's PERSONAL FINANCE

For individual investors with neither a lot of money nor a lot of time to devote to investing, mutual funds offer advantages that simply aren't available anywhere else. Instead of picking stocks or bonds one at a time, you can invest in a collection of them designed to match your investment goals. You can afford a high-priced, celebrity money manager with a fabulous track record. Mutual-fund managers do the work for you, pouring through reports on thousands of stocks and bonds in search of a handful they believe are good ones. They pool your money with that of other investors and assemble portfolios designed to achieve specific investment objectives, which are spelled out in the fund's prospectus (see the box on page 8). Thus, instead of digesting thousands of reports, you need to digest only a few. And you can monitor performance on a daily basis. It's a combination that's hard to beat.

Mutual funds can make investing easier, but it's a mistake to think they make it easy. Mutual funds have multiplied so rapidly that they now outnumber the 3,000-plus stocks listed on the New York Stock Exchange. The Investment Company Institute (ICI), the national association to which most funds belong, counts more than 8,500 of them as members. The ICI sorts funds into a couple of dozen categories according to investment objectives, ranging from high-risk aggressive stock funds that buy the shares of promising but unproven new companies to conservative bond funds that restrict their investments to the municipal bonds of a single state.

A Lot to Like About Mutual Funds

In addition to this amazing range of investment portfolios, funds offer a combination of shareholder services virtually impossible to find anywhere else.

- **Expert Portfolio Management.**
- **Automatic Diversification.** Owning shares of a mutual fund gives you a small ownership interest in all the stocks, bonds and other investments in the fund's portfolio. Whether your aim is to own a cross section of growth stocks or utility stocks, corporate bonds or gold-mining shares, you can find a fund or funds to suit you.
- **Ease of Purchase and Sale.** You can buy and sell funds through a broker or a bank through the mail or the phone or online. By law, a fund must buy back its shares when you want to sell them. The price at which fund shares are bought and sold is based on the fund's net asset value, or NAV, which is the market value of the fund's holdings, minus management expenses, divided by the number of fund shares outstanding. Because most mutual funds are regularly issuing new shares and buying back old ones, the number of shares is constantly changing.
- **Small Minimum Purchases.** Some funds will accept a minimum initial investment of as little as $250 or $500. A typical minimum to open an account is $1,000, with minimum additional investments of $50 or $100. Minimums are often less for individual retirement accounts (IRAs). Thus, mutual funds are ideal vehicles for long-term accumulation programs through dollar-cost averaging. And because funds will issue fractional shares, you can invest a flat amount regularly without worrying about whether you're buy-

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ing whole shares. For instance, $250 will buy 15.63 shares when a fund is selling for $16 a share. If it's selling for $15.50 the next time you buy, your $250 gets you 16.13 shares.

- **Automatic Reinvestment of Earnings.** Dividends paid by stocks in the fund's portfolio, interest from bonds, and capital gains earned from selling securities can be automatically reinvested for you in more shares. Reinvesting earnings is a critical element in any long-term investment plan.

- **Automatic Payment Plans.** If you'd like to receive regular income from your shares, in retirement perhaps, funds will set up automatic payment plans for you. If dividends and interest earned aren't enough to cover your payments, the fund will sell shares to cover them.

- **Shareholder Services.** Most funds have well-staffed toll-free telephone systems and Web sites to handle inquiries about everything from current account balances to requests for descriptive brochures and order forms. Companies that manage a group of funds, often called a family of funds, make it easy for you to switch your money from one member of the family to another—say, from a stock fund to a money-market fund—with a phone call or a few clicks of a computer mouse.

- **Easy Access to Information.** Fund prices are published in many newspapers daily. In addition, several tracking services follow funds and report their results over periods ranging from a month to ten years. The list of newspapers and magazines that publish comparative fund performance information in every issue is long and diverse. It ranges from broad-based personal finance publications such as *Kiplinger's Personal Finance* magazine and *Money*, which publish monthly lists of top fund performers in various categories and annual compilations of results for all mutual funds, to business and investment publications such as *Forbes, Barron's, Business Week*, the *Wall Street Journal* and *Investor's Business Daily.* The box located on page 7 describes a number of publications that contain comprehensive listings of mutual funds, including, in some cases, performance results.

The Cost of Mutual Fund Investing

In return for all this expertise and convenience, mutual funds charge a variety of fees. Like cars, hotels and stockbrokers, some funds give you more for your money than others.

It's tempting to divide funds neatly into two camps: load funds, which are sold mostly through brokers and charge you a commission when you buy shares, and no-load funds, which are sold directly to the public via advertising and don't charge a sales commission. Unfortunately, making the distinction is not that simple anymore. Before you can know what you're paying for, you need to check the prospectus for front-end loads, back-end loads and other kinds of fees that can sneak up on you if you don't watch out.

- **Front-End Loads.** Of the more than 2,500 funds ranked by Kiplinger recently, more than half charged a front-end load. A typical load is about 3.00% to 5.75%, often charged on a sliding scale that decreases with the size of the investment. For instance, one fund charges 5.75% on purchases of less than $50,000, 4.5% for a $50,000 to $100,000 investment, and so on until the load disappears for investors with $1 million or more. It's important to be aware that the load is calculated on the gross amount of your investment. If you invest $1,000 in a fund with a load of 5.75%, then $57.50 will be deducted as a sales charge and $942.50 will be invested in the fund's shares.

- **Back-End Loads.** Funds prefer to call these redemption fees. They are levied against the net asset value when you sell, thereby reducing your profit or adding to your loss. Several funds give investors a choice: pay a load to get in, or pay a load to get out.

- **Deferred Loads.** Sometimes called contingent deferred sales fees, these are deducted from the amount of your original investment if you redeem shares within a specified time after you buy them. The amount of the charge and the conditions under which you'll have to pay it are described in the prospectus. The purpose of deferred loads is to discourage you from jumping into and out of the fund.

- **Marketing Fees.** Some funds deduct the costs of advertising and marketing the fund directly from the fund's assets rather than absorbing them in the management costs. These annual charges, called 12b-1 fees, are typically around 0.25% to 1.25%. Sometimes a portion of the fee is paid to the broker who sold you the fund.

- **Fee Combinations.** Many funds complicate the picture by combining sales loads and annual fees to create several different fee structures, or share classes, from which investors must choose. So-called Class A shares are simple front-end loads, typically 3% to 5.75% of the amount invested. Class B shares are usually deferred loads that shrink a bit for each year you own the fund, and Class C shares charge little or nothing at the front or back but charge an annual 12b-1 fee that never disappears. Some funds further complicate matters by offering other share classes, dubbed Class F or Class Y, for example.

There is only one reason to pay a load of any kind, and that is to compensate your broker or other adviser for financial planning or analysis he or she does on your behalf.

If you do want such advice and plan to hold the fund for a long time, then a front-end load with minimal or no additional annual charges at least gets the charges paid at the beginning, when your balance in the fund is low. That suggests Class A or B shares. The B shares look tempting because their deferred sales charge disappears completely after several years, but this class often charges an annual 12b-1 fee that, because it rises along with your balance, may be the more costly route. The same is true of the C shares. So there is no easy answer here. Study the expense tables you'll find in the fund's prospectus and try to match the scenarios there to your own anticipated pattern of investing.

- Management Fees. All funds, whether they are load and no-load, must charge a management fee to compensate the portfolio managers for their services, pay the rent, pay brokerage commissions on portfolio transactions, and so forth. A typical management fee is 1.0 to 2% of the fund's assets. It may be either a flat rate or a sliding scale that shrinks as the value of the fund's portfolio grows. A fund's policy on management fees has nothing to do with its policy on sales fees. Careful inspection of the prospectus is the best way to determine these fees.

- Expense Ratio. The expense ratio is the cost of running the fund expressed as a percentage of the fund's assets. It's the best tool you have for comparing the management costs you'll incur by investing in different funds. The ratio includes management and 12b-1 fees, but not sales loads. The expenses are deducted from net assets and reflected in the percentage returns reported by the funds. Expense ratios can range up to 2.5% or more; the higher the ratio, the less the fund has left to pay its shareholders out of earnings.

To pick funds, look for those whose investing objectives and willingness to take risks match your own.

Find the Right Mutual Funds for You

In a way, worrying about management fees and expense ratios is putting the cart before the horse. The first task in choosing a mutual fund that's right for you is to narrow the field of thousands to a few appropriate candidates. You do that by concentrating on the funds whose investment objectives and willingness to take risks match your own. For those that make this first cut, compare performance records, expense ratios and shareholder services before deciding where to put your money. The resources listed on page 7 will help you get that information. Get answers to the following questions.

- **What Is the Fund's Investment Objective?** Most of the categories used to describe funds give a pretty good clue to the kinds of investments they make: growth, aggressive growth, corporate bond and long-term municipal bond, for example. The investment objective is a crucial piece of information, and all the sources listed on page 7 include it. A fund's goals should match yours.

- **What Is the Fund's Investment Style?** A fund's objective is a vital piece of information, but for stock funds it doesn't tell you everything important about how the fund goes about its business. Does it buy the stocks of big companies, medium-sized companies, small companies or all three? Does it like "value" stocks (under-priced companies) or fast growers? A fund's style profile can tell you these things.

  "Style" describes the stock funds according to the kinds of companies they invest in most heavily. Companies are divided into large (with a stock-market value of $10 billion or more), midsize (more than $1 billion but less than $10 billion) and small (under $1 billion). Note that the style size refers to a company's stock-market capitalization—the value of all its shares outstanding—not to its revenues. Companies are also characterized as rapidly growing, undervalued or a blend of the two. Bond fund styles are easier to grasp and in fact are often revealed in the name of the fund (high-quality corporate bond funds, for example).

- **What Is the Fund's Performance Record?** You want two pieces of information here: the fund's performance in relation to the market as a whole, and the fund's performance in relation to other funds of its type. Independently published guides, such as the *Individual Investor's Guide to Low-Load Mutual Funds* (see box on page 7) include it, either as part of a ranking system or in a form you can use to discern relative performance.

  Compare the total return (price changes plus reinvested earnings) over several years, not just for a year or two, and consider what was going on in the market during the periods being measured. A fund that maintains a good total return in good markets and bad deserves your attention, as does a fund that consistently does well when compared with funds of the same type.

- **Does the Fund Charge a Sales Fee?** Sales loads do make a difference. Consider two stock funds with similar records for five years. Fund A had a five-year annual average return of 10.9%, while for the same time period, Fund B had a return of 10.5%. Fund A seems to be the winner by a whisker, but it charges a 5.5% front-end load, while Fund B has no sales fee. Say you put $500 into each fund at the beginning of the period. Fund A immediately deducts $27.50 for the commission, leaving you with $472.50 working in the fund. Five years later, that amount has grown to $793. Not bad. But because Fund B has no sales fee, your entire $500 goes to work there, and in five years you'll have $824. That's $31 more despite the slightly smaller return.

  Of course, the hope is that paying a load will get you the investment advice you need to find a superior fund you might otherwise overlook. But loads don't pay for more research or more-talented fund managers; they pay for the advice of the broker or financial adviser who sells you the fund.

  This isn't to say you should never consider investing in a load fund. Some do beat the pack consistently, just not so often as some salespeople would like you to believe. If your knowledge of funds is minimal, relying on a broker or financial planner to recommend funds that fit your goals may make sense.

- **What Is the Fund's Expense Ratio?** The expense ratio, which was discussed on page 4, shows how much of your potential earnings get eaten up by the costs of running the fund. Pay attention to this number, but don't fixate on it. The fund must subtract expenses (except for sales fees) before calculating its total return, and the total return is a much more important number.

- **What Service Does the Fund Offer?** Some funds make it easier than others to open and close accounts, get information about net asset values, switch from one fund to another within the same family, and so forth. A fund family is a collection of funds run by the same company. Most families make it easy to switch from one family fund to another by letting you do it over the telephone or online.

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They want to keep you in the family even though your objectives may change. You can get information about special privileges offered by families from prospectuses and accompanying literature.

Different Strokes for Different Folks

The following major groupings of funds offer more options than you'll probably ever use. You'll want to diversify with selections from several groups, and your choices will depend on your risk tolerance and length of time you have until you'll need the money. These definitions match the groupings you'll usually see in quarterly or annual rankings of fund performance in many newspapers and magazines.

FUNDS FOR LONG-TERM INVESTORS.

This is by far the biggest category of funds that invest in stocks and bonds. Some are more volatile than others, but all should be considered long-term investments that you anticipate holding for a minimum of five years.

GROWTH FUNDS. These seek long-range capital gains by investing in large, established companies whose stock prices are expected to rise faster than inflation. Growth-stock funds are best suited for investors who want steady growth over the long term but have little need for income in the meantime. Funds in this group generally carry average risk and above average risk.

GROWTH-AND-INCOME FUNDS. Like growth funds, these invest in common stocks of well-established companies. But growth-and-income funds also seek current dividend income. Risk ratings tend to be low to average for this group. The goal of these funds is to provide long-term growth without much fluctuation in share price, even in declining markets.

BALANCED FUNDS. These funds own both stocks and bonds, usually in a fixed proportion. Top performers in this category tend to own more stocks than bonds.

INDEX FUNDS. The idea behind index funds is simple enough: It's tough to beat the market consistently, so why try? These funds don't try. Instead, they buy stocks that form the market index they seek to track—the S&P 500, the S&P 100 and the Dow Jones industrials are most popular. Theoretically, this approach should yield a return that matches the index. In practice, some portfolio managers of index funds try to beat the index they're tracking. All index funds come very close to achieving their goals, making them a conservative way to invest in the market. Risk, because it matches the market exactly, is moderate.

FLEXIBLE PORTFOLIO FUNDS. Unlike funds that carefully limit the kinds of investments they make, flexible funds can swing back and forth—from all stocks to all bonds or all cash, or any mixture of investments—depending on where the funds' managers think is the best place to be at the time. Some of these funds are also known as asset allocation funds. Risk here varies from low to high, so it's important to check risk ratings with the mutual fund information sources listed on page 7.

GLOBAL FUNDS. Investments of these funds don't stop at the border. They invest around the world, and at any time may have a majority of their portfolios in foreign stocks. Global funds and the next category, international funds, can make or lose money two ways: on the prices of the stocks they buy, and on the movements of currency values compared with the U.S. dollar. Because so many of these funds are relatively new and their records short, volatility rankings often aren't reliable indicators of risk. International and global funds should be chosen with special care.

INTERNATIONAL FUNDS. These are global funds that invest most or all of their assets in companies located outside the U.S.

SOCIALLY SCREENED FUNDS. Environmental awareness infuses the portfolio choices of some of these funds. Others take care to avoid investing in weapons manufacturers, nuclear-energy producers, cigarette makers, and so on. Many also look for companies known for enlightened personnel and operating policies. As a group, these funds tend to deliver a return that is competitive with funds that have similar investment objectives and comparable risk.

FUNDS FOR INCOME-ORIENTED INVESTORS.

Funds designed primarily to generate income hold mostly bonds and fluctuate in price more because of interest-rate changes than stock-market movements. The following categories are suitable for the bond portion of your portfolio allocation but

SOURCES OF MUTUAL FUND INFORMATION

Several personal-finance and investment magazines rank the top-performing mutual funds on a monthly basis and rank most funds on an annual basis. Among the popular periodicals covering funds on a regular basis are *Business Week, Forbes, Kiplinger's Personal Finance* magazine, *Money, Mutual Funds* and *SmartMoney*. Barron's publishes fund rankings quarterly. All provide information on their Web sites: businessweek.com offers a mutual fund interactive scoreboard and selected stories free, and you must subscribe for access to the rest of the site; forbes.com, kiplinger.com, money.com, and smartmoney.com all offer free financial information, portfolio tracking and calculators; barrons.com offers financial information and portfolio tracking for a fee.

The following publications and services provide comprehensive directories to funds, usually arranged according to investment objectives. Where indicated, these guides can also be valuable sources of information on fund performance. They are available in libraries, directly from the publisher and, in some cases, on the Internet or in bookstores.

Mutual Fund Fact Book
A guide to statistics and trends in the mutual fund industry, published by the Investment Company Institute (ICI), an industry association. You can read it on the institute's Web site or buy a hard copy. No performance information. Updated annually ($30.; 401 H St., NW, Suite 1200, Washington, DC 20005; 202-326-5800; www.ici.org). ICI's Web site also provides a list of mutual fund families that are members of the Institute, with phone numbers and Web addresses when available.

Individual Investor's Guide to Low-Load Mutual Funds
Comprehensive information on about 900 no-load funds, compiled by the American Association of Individual Investors, whose members get the book free. Includes performance records, risk ratings and information on portfolio holdings. Updated annually ($30.; 625 N. Michigan Ave., Chicago, IL 60611; 800-428-2244; www.aaii.org).

Kiplinger's Mutual Funds
An annual newsstand guide to choosing the best funds, with advice for novices

Morningstar Inc.
225 W. Wacker Dr., Chicago, IL 60606; 800-735-0700; www.morningstar.com).

Value Line Mutual Fund Survey
A biweekly publication analyzing the performance of more than 2,000 mutual funds ($345/yr., Value Line Publishing, 220 E. 42nd St., New York, NY 10017; 800-634-3583; www.valueline.com).

may not be appropriate for long-term growth. Volatility tends to be on the low side.

HIGH-QUALITY CORPORATE BONDS. These stick mostly to the bonds of top-rated companies with the best prospects for paying interest and principal on time. The average maturities of their holdings will vary, although some funds specialize in short- or intermediate-term issues of two to seven years. A few concentrate on zero-coupon bonds, signaled by the words "target maturities" in the name.

WHAT TO LOOK FOR IN A MUTUAL FUND PROSPECTUS

A mutual fund prospectus is an awkward cross between a sales pitch and a legal treatise. It is the basic information document that all fund sellers must provide to prospective investors. In it you'll find a summary of fees and expenses, instructions for buying and redeeming shares, plus descriptions of fund objectives, management and shareholder services.

The prospectus shouldn't be the only thing you read from or about the fund, but it is among the most important. Here's what you can get out of it:

How do the fund's objectives match your own? Every prospectus has a discussion of the fund's objectives. It may appear in a section labeled "objectives," "highlights" or "summary." Read this section very carefully, because it reveals how the fund intends to make money and what kinds of risks it will take. Will the fund invest in high-dividend stocks? Will it look for fast profits or long-term growth? Will it take chances you'd rather not take? Pay especially close attention to the fund's guidelines concerning the quality of its investments.

How risky is the fund's strategy? Many prospectuses include a general discussion of risks. Pay attention to it. In other prospectuses, you may have to ferret out this information. Studying the fund's performance can give you a sense of how well it has handled risks in the past.

How much will it cost you to invest? Tables in every prospectus will tell you whether the fund imposes a load, or charge, when you buy, reinvest or redeem shares; they'll also spell out annual operating costs. As a rule, a company that keeps its expenses at 1% or less of its assets is considered a low-cost fund; the average stock fund charges 1.5%.

How has the fund done in the past? A

have fared had you owned shares of the fund over the past decade, assuming it has been around that long. Dividends, capital-gains distributions and the share price at the beginning and end of each year are included. Also listed is the fund's portfolio turnover rate, which is a measure of how often it buys and sells securities. Generally, the higher the rate, the greater the fund's expenses. A rate exceeding 100%—meaning the fund replaced the equivalent of its entire portfolio in the period measured—is a sign of an aggressively managed fund or a fund operating in perilous markets. For instance, a bond fund would tend to log a low turnover rate in a period of steady or declining interest rates but a high turnover when rates head up.

The performance section lists yield and total-return figures. Total return includes income and changes in share price during the period being measured and assumes that such payouts are reinvested in additional shares.

How do you buy and redeem shares? The key information here is the minimum purchase accepted and minimum subsequent purchases. In the case of a money-market fund, also check the minimum redemption amount. If you plan to use the fund as an interest-earning checking account, for example, you probably won't want one that imposes a $1,000 minimum on redemptions by check.

What securities does the fund own? One thing you won't find in the prospectus is a listing of which securities the fund actually owns. You can get that information, though, in the fund's Statement of Additional Information and its latest quarterly or annual reports. Ask for copies when you request the prospectus, but keep in mind that portfolio holdings change often and your report is bound to be at least a little out of date. Information regarding a fund's top ten holdings is available free online at the fund's Web site or on Morningstar's Web site, www.morningstar.com with QuicktakeReports feature, a scaled-down version of Morningstar's by-subscription service (see page 7).

GLOBAL BOND FUNDS. These funds buy bonds issued by foreign companies as well as U.S.-headquartered firms. If the value of the currency of a country rises in relation to the dollar, funds owning bonds from that country benefit from the exchange rate, which can give their portfolios an added boost. If the dollar rises, however, the fund suffers. If you understand the dynamics of such currency movements, it may be appropriate to use global funds for a portion of your portfolio.

U.S. GOVERNMENT BOND FUNDS. As the name implies, these funds invest in IOUs issued by the Treasury and backed by the full faith and credit of the federal government. They may also invest in debt issued by federal agencies, which don't carry the full government backing but are considered just as safe.

GINNIE MAE FUNDS. The funds concentrate on Ginnie Mae certificates, although they also buy other kinds of mortgage-backed securities. Their yields tend to reflect current mortgage rates. It is important to remember that mortgage funds will be more volatile than bond funds when long-term interest rates are falling because homeowners tend to refinance, taking their higher-rate mortgages out of the pool.

MUNICIPAL BOND FUNDS. These funds buy tax-free bonds that are issued by state and local governments and their agencies. Some specialize in single states, but most buy from a broad range of issues around the country.

Ginnie Mae Fund yields tend to reflect current mortgage rates.

FUNDS FOR AGGRESSIVE INVESTORS.

These funds go for profits by investing in risky stocks or bonds that, in the opinion of the funds' managers, have a chance to hit it big. This is a high-risk environment suitable for investors with a long time horizon or experienced, knowledgeable ones.

AGGRESSIVE-GROWTH FUNDS. These seek maximum capital gains and don't care about dividends. They look for companies or industries that are down-and-out but show prospects for a turnaround, or fledglings with prospects but no track records.

HIGH-YIELD BOND FUNDS. "High-yield" is the salesperson's name for junk. These funds come in both the corporate and municipal varieties and invest in bonds rated low by rating services. The interest paid, or yield, is several points higher than what's available from investment-grade bond funds. The risks of default are also higher. Such a fund could be a prudent risk for a very small part of your portfolio.

SINGLE-INDUSTRY FUNDS. If you have a special interest in a market niche—gold, biotechnology or health care companies, for example—there's probably a fund that can accommodate you. Rather than assembling a diversified portfolio spanning a number of different industries, sector funds concentrate on a single industry. Thus, their fortunes rise and fall with that industry's fortunes, and their volatility rankings tend to be above average.

EXCHANGE-TRADED FUNDS.

Exchange-traded funds (ETFs), the fastest-growing segment of the fund industry, have grown from none a dozen years ago, to more than 175 ETFs holding about $228 billion in assets. ETFs own a fixed portfolio of securities and can be bought and sold any time of the day that the stock market is open. They don't tend to develop significant discounts or premiums.

An exchange-traded fund's portfolio represents a slice of the market—an index, a sub sector of an index or a particular industry. You buy and sell them through a broker, just like ordinary stocks. ETFs also come in more varieties than conventional index funds and tend to cost even less than the least costly traditional index fund.

The biggest drawback of ETFs is the brokerage commission you pay each time you buy or sell one. Investors engaged in dollar-cost averaging might be better off using regular index funds. But if you plan to buy and sell in large chunks and you trade through a discount broker, a commission of $10 or so may be acceptable to you.

The major reasons to consider them are:

- **Lower Management Fees**—due in part to the economics of indexing, which minimizes the need for managers and analysts.

- **Lower Taxes**—Because ETFs and index funds don't buy and sell very much, there is rarely any reason to distribute anything except dividend income, which is minimal.

How Much Are You Making?

By consulting the performance rankings of mutual funds that appear regularly in *Kiplinger's Personal Finance* magazine and other publications, you can get a pretty good idea of how well your fund is doing relative to other funds. But that doesn't necessarily tell you how well you're doing.

The mutual fund listings in newspapers report the net asset value (NAV) of fund shares. NAV is a fund's total assets divided by the number of shares outstanding. Relying on changes in the NAV of your fund would probably understate your return because the NAV doesn't tell you whether the fund has paid any dividends or distributed any capital gains over the period being measured. Fixing on yield will also mislead you. Yields express dividends or interest as a percentage of the price; they don't reflect how the shares themselves may have risen or fallen in value.

TOTAL RETURN IS THE BEST MEASURE.

What really counts is your fund's total return—the total wealth generated by your initial investment for the time you're invested in the fund. That includes share appreciation as well as dividends, interest, and capital-gains distributions from securities the fund sells at a profit. A capital-gains payment actually reduces the NAV because the fund pays out money that used to count as part of the value of its portfolio.

Your personal rate of return over a given period will be influenced by whether—and when—you purchased or redeemed shares, whether you took your dividends and capital gains in cash or reinvested them, and whether you paid a sales load. Your quarterly and annual reports from the fund will stress total return, and you can approximate it in the meantime by using information that's typically included on your account statement, plus what you can learn from the newspaper listings.

Protect Your Money: How to Check Out a Broker or Adviser

Federal or state securities laws require brokers, advisers, and their firms to be licensed or registered, and to make important information public. But it's up to you to find that information and use it to protect your investment dollars. The good news is this information is easy to get, and one phone call or web search may save you from sending your money to a con artist, a bad broker, or disreputable firm.

This is very important, because if you do business with an unlicensed securities broker or a firm that later goes out of business, there may be no way for you to recover your money — even if an arbitrator or court rules in your favor.

BROKERS AND BROKERAGE FIRMS.

The Central Registration Depository (or "CRD") is a computerized database that contains information about most brokers, their representatives, and the firms they work for. For instance, you can find out if brokers are properly licensed in your state and if they have had run-ins with regulators or received serious complaints from investors. You'll also find information about the brokers' educational backgrounds and where they've worked before their current jobs.

You can ask either your State Securities Regulator or NASD to provide you with information from the CRD. Your State Securities Regulator may provide more information from the CRD than NASD, especially when it comes to investor complaints, so you may want to check with them first. You'll find contact information for your State Securities Regulator on the North American Securities Administrators Association (NASAA) Web site (www.nasaa.org). To contact NASD, go online to www.nasd.com, or call 800- 289-9999.

INVESTMENT ADVISERS.

People or firms that get paid to give advice about investing in securities must register with either the U.S. Securities and Exchange Commission (SEC) or the State Securities Regulator where they have their principal place of business. Investment advisers who manage $25 million or more in client assets generally must register with the SEC. If they manage less than $25 million, they generally must register with the State Securities Regulator.

Some investment advisers employ investment adviser representatives, the people who actually work with clients. In most cases, these people must be licensed or registered with your State Securities Regulator to do business with you. So be sure to check them out.

To find out about advisers and whether they are properly registered, read their registration forms, called the "Form ADV," which has two parts. Part 1 has information about the adviser's business and whether they've had problems with regulators or clients. Part 2 outlines the adviser's services, fees and strategies. Before you hire an investment adviser, always ask for and carefully read both parts of the ADV.

You can view an adviser's most recent Form ADV online at www.adviserinfo.sec.gov. The database contains Forms ADV only for investment adviser firms that register electronically using the Investment Adviser Registration Depository, but will expand to encompass all registered investment advisers—individuals as well as firms.

You can also get copies of Form ADV for individual advisers and firms from the investment adviser, your State Securities Regulator (see the box below), or the SEC, depending on the size of the adviser. To contact your State Securities Regulator go online to www.nasaa.org. If the SEC registers the investment adviser, you can get the Form ADV for $ .24 per page (plus postage) from the SEC.

Investment advisers must register with either the SEC or State Securities Regulator where they do business.

WRAP UP.

As the title of this booklet suggests, mutual funds offer just about everything most investors need—plenty of choices from no-risk government bond funds to very high-risk speculative, or junk-bond funds, and everything in between. Because every mutual fund invests in a number of stocks or bonds, you get instant diversification when you invest in one, and by investing in a few you diversify even more. If you need assistance deciding what to buy, load funds offer expert advice; if you do the research on your own, no-load funds can save you money. For the average investor, mutual funds may be the best place to put their money.."

STATE SECURITIES REGULATORS

State Securities Regulators have protected investors from fraud for nearly 100 years. Securities markets are global but securities are sold locally by professionals who are licensed in every state where they conduct business. State Securities Regulators work within your state government to protect investors and help maintain the integrity of the securities industry.

Your State Securities Regulator can:

- Verify a broker-dealer or investment adviser is properly licensed;
- Provide information about: prior run-ins with regulators that led to disciplinary or enforcement actions; serious complaints that may have been lodged against them; their educational background and prior work history
- Provide a computer link or telephone number or address where you can file a complaint; and
- Provide non-commercial investor education and protection materials.

For contact information for your State Securities Regulator, visit the North American Securities Administrators Association (NASAA) Web site at www.nasaa.org and click on "Contact Your Regulator."

GLOSSARY

Bear market— A period when the stock market in general declines.

Bond— An interest-bearing security that obligates the issuer to pay a specified amount of interest for a specified time, usually several years, and then repay the bondholder the face amount of the bond.

Bond rating— A judgment about the ability of a bond issuer to fulfill its obligation to pay interest and repay the principal when it is due.

Bull market— A period when the stock market in general increases.

Capital gain (and loss)— The difference between the price at which you buy an investment and the price at which you sell it.

Diversification— The method of balancing risk by investing in a variety of securities.

Dividends— Shares of company earnings paid out to stockholders.

Dollar-cost averaging— A program of investing a set amount on a regular schedule regardless of the price of the shares at the time.

Ginnie Mae— A dual-purpose acronym standing for both the Government National Mortgage Association (GNMA) and the mortgage-backed securities that the government agency packages, guarantees and sells to investors.

Individual Retirement Account (IRA)— A tax-favored retirement plan. Contributions to a regular IRA may be tax deductible, depending on your income and if you are covered by a retirement plan at work. Earnings grow tax-deferred in a regular IRA. Earnings in a variation, the Roth IRA, grow tax-free, and contributions are made with after-tax dollars.

Load— A sales commission charged by many mutual funds. Some are front-end loads (fee paid when the shares are purchased) or back-end loads (fees paid when the shares are sold).

Maturity— The amount of time it takes for a bond to pay the face value. Bonds are issued with varying maturity dates.

Money-market fund— A mutual fund that invests in short-term corporate and government debt and passes the interest payments on to shareholders.

Mutual fund— A professionally managed portfolio of stocks and bonds or other investments divided up into shares.

Net asset value (NAV)— The result of dividing a fund's total assets by the number of shares outstanding.

Portfolio— The collection of all of your investments.

The following booklets from the Editors of *Kiplinger's Personal Finance* magazine, the Investor Protection Trust and the American Library Association are available at your library.

FIVE KEYS TO INVESTING SUCCESS

- Make investing a habit
- Set exciting goals
- Don't take unnecessary risks
- Keep time on your side
- Diversify

THE BASICS FOR INVESTING IN STOCKS

- What is a stock?
- Types of stocks and their relative risks
- How to buy stocks
- Stock terms you need to know, such as price/earnings ratio (P/E), book value, dividend yield and dollar-cost averaging
- Selling your stocks and determining earnings
- Mistakes even seasoned investors sometimes make—and how to avoid them

A PRIMER FOR INVESTING IN BONDS

- What is a bond?
- How bonds work
- Types of bonds and their relative safety
- Why bonds can be an important part of your investment portfolio
- Yield and how it relates to bond prices
- Bond ratings and how they can help you reduce risk

MUTUAL FUNDS: MAYBE ALL YOU'LL EVER NEED

- What is a mutual fund?
- Advantages of investing in mutual funds
- Cost of investing in mutual funds
- Find the right mutual funds for you
- What to look for in a mutual fund prospectus
- Types of mutual funds and relative risk
- Determining your earnings

GETTING HELP WITH YOUR INVESTMENTS

- Choosing a broker
- Full-service, discount and online brokers
- Opening a brokerage account
- Records you need to keep
- Problems with your broker
- Financial advisers
- How to choose an adviser
- Investment clubs

WHERE TO INVEST YOUR COLLEGE MONEY

- Creating a college fund portfolio based on your time horizon
- College investment vehicles
- State-sponsored college savings plans

MAXIMIZE YOUR RETIREMENT INVESTMENTS

- Three fundamental truths about retirement investing
- Stocks, bonds and mutual funds to consider for your retirement portfolio
- Determining your portfolio mix, depending on your time horizon and risk tolerance
- Retirement investment vehicles

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